IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF WEST VIRGINIA
AT MARTINSBURG

BANK OF CHARLES TOWN,

Plaintiff,

v.

CIVIL ACTION NO. 3:10-CV-00102-JPB
(Removed from the Circuit Court of
Jefferson County, No. 10-C-312)

ENCOMPASS INSURANCE,
ENCOMPASS INDEMNITY COMPANY,
MICHELLE GROSSMAN,
JOHN WILSON, AND JOHN OR JANE DOE,

Defendants.

MEMORANDUM IN SUPPORT OF MOTION TO DISMISS

Defendant Encompass Indemnity Company, by counsel, states as follows in support of its Motion.[1]

RELEVANT BACKGROUND AND BANK'S CLAIMS

Plaintiff, Bank of Charles Town (Bank), seeks recovery for alleged water damage to real property (the Home) at 11 Seattle Slew Way, Martinsburg, West Virginia. *Complaint*. Bank alleges

- that James A. Howard owned the Home, and that Howard and Monte I. Palmer and Suzette S. Palmer executed the *Agreement for the Purchase and Sale of Improved Real Property with Preoccupancy Provision* dated October 10, 2008 (the Installment Contract). *Complaint* ¶ 11 and its Exhs. A, Installment Contract, and B, Policy Declarations;
- that the Palmers applied for a homeowners policy and that Encompass Indemnity Company

[1]See also *Motion to Dismiss Encompass Insurance*.

issued USP Special Value Policy No. 281216751 (the Policy) to the Palmers;

- that the Policy listed Howard, and after his death, his estate, "as a person with an interest in" the Home, and listed "Bank of Charles Town ATIMA" as Mortgagee.[2] *Id.* ¶¶ 13, 15, 20 and Exh. B, Policy Declarations;
- that the Palmers had an insurable interest in the Home although the Installment Contract "stated that the risk of loss was to be borne by" Howard. *Complaint* ¶ 14 (citing *Filiatreau v. Allstate Ins. Co.*, 358 S.E.2d 829 (W. Va. 1987));
- that Encompass Indemnity Company knew or should have known of the Installment Contract and the relationship between or among the Palmers, Howard, and Bank. *Id.* ¶¶ 16, 17;
- that Encompass Indemnity Company accepted the Palmers' premium payments for the Policy. *Id.* ¶ 19;
- that Bank completed its foreclosure on the Home on May 27, 2010. *Id.* ¶¶ 20, 21;
- that Bank first advised the Palmers of its foreclosure on May 28, 2010. *Id.* ¶ 22;
- that water damage occurred at the Home on June 2, 2010. *Id.* ¶ 23;[3]
- that the Palmers timely notified Bank and Encompass Indemnity Company; and that named Defendant Michelle Grossman (Grossman) investigated the Palmers' claim (the Water Damage Claim) and discussed it with the Palmers, in the presence of a Bank representative, and that Grossman's supervisor, named Defendant John Willson (incorrectly named in the

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[2]ATIMA ("As Their Interest May Appear") shows that a lienholder's interest in the property insured varies with the outstanding debt owed to the lienholder at the time of a loss.

[3]Encompass Indemnity Company's investigation indicates that Mr. Palmer first noted a water overflow on May 31, 2010.

Complaint as John Wilson), was also involved in the matter. *Id.* ¶¶ 24-33; and

- that "[p]ursuant to the [Policy's] standard mortgage clause[,]" Bank had "an independent and distinct contract with" Encompass Indemnity Company. *Id.* ¶ 35 (citing *FirstBank Shinnston v. West Virginia Ins. Co.*, 408 S.E.2d 777 (W. Va. 1991)).

Based on those allegations, Bank alleges Encompass Indemnity Company's breach of contract and common law bad faith, *id.* Count I, and all Defendants' violation of the Unfair Trade Practices Act (the UTPA), W. Va. Code § 33-11-4(9)(c), (e), (n), and its legislative rules. *Id.* Count II. Bank seeks a declaration that it is entitled to "information concerning the status of" the Water Damage Claim, and that Bank is entitled to the Policy's coverage of the Water Damage Claim because Bank is the "listed 'mortgagee' and first-party insured under" the Policy. *Id.* Count III. Bank alleges that Encompass Indemnity Company is estopped to deny Policy coverage to Bank and that Defendants "waived their right to challenge the Palmers' insurable interest after the water damage claim was made under" the Policy. *Id.* Count IV.

LEGAL STANDARD

The Court " appl[ies] state substantive law and federal procedural law in diversity cases." *Hottle v. Beech Aircraft Corp.*, 47 F.3d 106, 109 (4th Cir. 1995). A valid complaint must contain "'a short and plain statement of the claim showing that the pleader is entitled to relief,' in order to 'give the defendant fair notice of what the ... claim is and the grounds upon which it rests.'" *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (citations omitted)); *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1961 (2009) (quoting *Twombly*, 550 U.S. at 555 (inner citations omitted).

Factual allegations are still "taken as true[;]" *Twombly*'s "requirements were embodied in the Supreme Court's 'plausibility standard,'" which "merely called for plaintiffs to set forth enough facts ... to raise a reasonable expectation that discovery will reveal evidence supporting the claim." *Spear Pharmaceuticals, Inc. v. William Blair & Co., LLC*, 610 F.Supp.2d 278, 283 (D. Del. 2009) (citation omitted). The Court must still "draw all reasonable inferences in the plaintiff's favor[,]" but a complaint must show "'the plaintiff's grounds for entitlement to relief - including factual allegations that when assumed to be true "raise a right to relief above the speculative level."'" *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 232 (5th Cir. 2009) (citations omitted). The Court may take judicial notice of "'items in the public record.'" *Hall v. Virginia*, 385 F.3d 421, 424 n.3 (4th Cir. 2004) (quoting *Papasan v. Allain*, 478 U.S. 265, 268 n. 1 (1986)).

> Although as a general rule extrinsic evidence should not be considered at the 12(b)(6) stage, we have held that when a defendant attaches a document to its motion to dismiss, "a court may consider it in determining whether to dismiss the complaint [if] it was integral to and explicitly relied on in the complaint and [if] the plaintiffs do not challenge its authenticity."

Am. Chiropractic Ass'n v. Trigon Healthcare, Inc., 367 F.3d 212, 234 (4th Cir. 2004) (citation omitted); *Blankenship v. Manchin*, 410 F.Supp.2d 483, 487 (S.D.W. Va. 2006) (quoting *Am. Chiropractic*, 367 F.3d at 234 (inner citation omitted)).[4]

In this case, Bank attached the Policy's declarations and expressly relies on the Policy's "standard mortgage clause[.]" *Complaint* ¶ 35. Encompass Indemnity Company asks the Court to

[4]Bank's *Complaint* also fails West Virginia's test, under which a 12(b)(6) motion "'test[s] the formal sufficiency of the complaint[]'" so that the Court may "weed out unfounded suits.'" *Yoak v. Marshall Univ. Bd. of Governors*, 672 S.E.2d 191, 195 (W. Va. 2008) (citations omitted). A state court is to dismiss an action only if "'it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" *Harrison v. Davis*, 478 S.E.2d 104, 109 (W. Va. 1996) (citations omitted). The state court reads the complaint liberally and may consider documents "fairly incorporated within" the complaint or "matters ... susceptible to judicial notice[,]" *Forshey v. Jackson*, 671 S.E.2d 748, 750, 752 (W. Va. 2008) (citations omitted), but it may "'ignore legal conclusions, unsupported conclusions, unwarranted inferences and sweeping legal conclusions cast in the form of factual allegations.'" *id.* at 761 (citation omitted).

consider the Policy's declarations and its Mortgage Clause. *Id.* Exh. B, Policy declarations; Motion, **Exhibit B**, Policy's Mortgage Clause; *Forshey*, 671 S.E.2d at 750; *Blankenship*, 410 F.Supp.2d at 487; *Am. Chiropractic*, 367 F.3d at 234. Encompass Indemnity Company asks the Court to take judicial notice of the Report of Sale, of record in the Office of the County Clerk of Berkeley County, West Virginia, in Book 68 at Page 65, confirming Bank's foreclosure on the Home parcel, legally described as Lot 2, Willow Brook Subdivision Section II. *Complaint*, Exh. A, Installment Contract (legal description of Home); *Forshey*, 671 S.E.2d at 752; *Hall*, 385 F.3d at 424 n.3.

DISCUSSION

Neither the Palmers nor Howard had an insurable interest as owner of the Home on the date of loss. Bank had no insurable interest as Mortgagee of the Home on the date of loss. The Policy was void.

Encompass Indemnity Company may issue a homeowners policy like the Policy only "for the benefit of persons having an insurable interest in the things insured." W. Va. Code § 33-6-3(a); Syl. Pt. 1, *Filiatreau*, 358 S.E.2d 829 (one "taking out a fire insurance policy must have an insurable interest in the subject matter and if such interest is lacking, the policy is void."). An "insurable interest" is "any actual, lawful, and substantial economic interest in the safety or preservation of the subject of the insurance free from loss, destruction, or pecuniary damage or impairment." W. Va. Code § 33-6-3(b). Solely for purposes of this Motion, it is assumed that the Palmers may at some point have had an insurable ownership interest in the Home and that the Policy may have been valid when issued.[5]

[5]Neither the *Complaint* nor the Installment Contract supports such a conclusion. As the *Complaint* and the Installment Contract make clear, Howard was the Home's owner until Bank became its owner upon foreclosure. Bank was Howard's mortgagee, but Bank never had any legal

On May 27, 2010, Bank foreclosed on the Home. *Complaint* ¶¶ 20, 21. A "foreclosure" is "a legal proceeding to terminate a mortgagor's interest in property, instituted by the mortgagee either to gain title or to force a sale in order to satisfy the unpaid debt secured by the property." 55 Am.Jur.2d *Mortgages* § 573 (citation omitted). As a matter of law, Howard's ownership interest in the Home terminated on May 27, 2010. *Id.*; *Jones v. Wesbanco Bank Parkersburg*, 460 S.E.2d 627, 628 n. 1 (W. Va. 1995) (citing *Firstbank Shinnston*, 408 S.E.2d at 781; other citation omitted); Report of Sale, Berkeley County, West Virginia, Book 68 at Page 65.

The mortgagor's interest is not the only interest that terminates: upon foreclosure, """[t]he land [is] no longer mortgaged land. With relation thereto the [mortgagee] was no longer the mortgagee thereof holding title thereto for security, but was the owner thereof free from the mortgage.""" *Santiago ex rel. Santiago v. Alba Management, Inc.*, 928 N.E.2d 359, 362 (Mass. App. 2010) (citations omitted). Bank was never the Palmers' mortgagee, and as a matter of law, on May 27, 2010, Bank became the Home's owner and ceased to be even Howard's mortgagee. *Id.*; 55 Am.Jur.2d *Mortgages* § 573; *Jones*, 460 S.E.2d at 628 n. 1.

In addition, Howard and the Palmers "covenant[ed] and agree[d] that should the Seller [Howard] be foreclosed on, ... the sale ... terminated immediately." *Complaint* Exh. A, Installment Contract ¶ 4. That is, any assumed insurable interest of the Palmers terminated on May 27, 2010. *Id.*; Syl. Pt. 2, *Bethlehem Mines Corp. v. Haden*, 172 S.E.2d 126 (W. Va. 1969) (Court applies clear contract terms); W. Va. Code § 33-6-3(b).

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relationship with the Palmers. The Installment Contract suggests that the Palmers were at most renters before the foreclosure, but that they had no insurable interest in the real property.

Encompass Indemnity Company is investigating the Water Damage Claim under reservation of rights. Motion, **Exhibit A**, letter 6/11/10.

Bank's Counts I-IV are based on its allegation that ""[p]ursuant to the [Policy's] standard mortgage clause[,]" Bank had "an independent and distinct contract with" Encompass Indemnity Company. *Complaint* ¶ 35 (citing *FirstBank Shinnston*, 408 S.E.2d 777).[6] Bank loaned money to Howard, the Home's owner, see Report of Sale, Berkeley County, West Virginia, Book 68 at Page 65, not to the Palmers, but in any case, the Policy contains a standard mortgage clause:

> 2. Mortgage Clause.
>
> The word "mortgagee" includes trustee. A mortgagee is applicable only to real property. If a mortgagee is named in this policy, any loss payable shall be paid to the mortgagee and you,[7] as interests appear. If more than one mortgagee is named, the order of payment shall be the same as the order of precedence of the mortgages.
>
> If we deny your claim, that denial shall not apply to a valid claim of the mortgagee, if the mortgagee:
> a. Notifies us of any change in ownership or occupancy, or any substantial change in risk of which the mortgagee is aware;
> b. Pays on demand any premium due, if you have neglected to pay the premium; and
> c. Submits a signed, sworn statement of loss within 60 days after receiving notice from us of your failure to do so. Policy conditions relating to Appraisal, Who We Pay and Suit Against Us apply to the mortgagee.
>
> If the policy is canceled or nonrenewed the mortgagee shall be notified at least ten days before the date cancellation takes effect.

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[6]The independent contract rule applies only if "the lender under a deed of trust executed by a property owner to secure a debt owing on the property is named as mortgagee in a standard mortgage clause in a fire insurance contract between an insurer and a property owner[.]" Syl. Pt. 4, *Jones*, 460 S.E.2d 627. In such a case, the lender is deemed "an insured to the extent of the balance due it from the property owner[,]" and its right "to the insurance proceeds is determined at the time of the fire loss to the extent of the balance due it from the property owner." *Id.*

[7]The Policy provides that "'You' and 'your' refer to the person shown as the 'Named Insured' in the Coverage Summary and his or her spouse if a resident of the same household."

> If we pay the mortgagee for any loss and deny payment to you:
>
> a. We are subrogated to all the rights of the mortgagee granted under the mortgage on the property; or
>
> b. At our option, we may pay to the mortgagee the whole principal on the mortgage plus any accrued interest at the time of loss. In this event, we shall receive a full assignment and transfer of the mortgage and all securities held as collateral to the mortgage debt.
>
> Subrogation shall not impair the right of the mortgagee to recover the full amount of the mortgagee's claim.
>
> 3. Insurable Interest.
>
> We are not liable for covered property to an extent greater than:
> a. Your insurable interest in the property; or
> b. The applicable limit of liability.

Motion, **Exhibit B**, Policy excerpt.

The Water Damage Claim arose on May 31 or June 2, 2010, but even if the Palmers were assumed to have had an insurable interest when the Policy was issued, and the Policy were assumed to have insured such an interest in the Home, Bank's foreclosure ended any such interest on May 27, 2010. *Complaint* ¶¶ 20, 21 and its Exh. A, Installment Contract ¶ 4; Report of Sale, Berkeley County, West Virginia, Book 68 at Page 65; *Santiago*, 928 N.E.2d at 362; Syl. Pt. 2, *Bethlehem Mines*, 172 S.E.2d 126; 55 Am.Jur.2d *Mortgages* § 573; *Jones*, 460 S.E.2d at 628 n. 1. As to the Palmers, the Policy was void on June 2, 2010. W. Va. Code § 33-6-3(a), (b); Syl. Pt. 2, *Stanley*, 602 S.E.2d 483; Syl. Pt. 1, *Filiatreau*, 358 S.E.2d 829.

Even if the Policy were assumed to be valid and to have insured Howard's interest in the Home, Bank's foreclosure terminated his interest on May 27, 2010. 55 Am.Jur.2d *Mortgages* § 573; *Jones*, 460 S.E.2d at 628 n. 1; *Santiago*, 928 N.E.2d at 362; Report of Sale, Berkeley County, West

Virginia, Book 68 at Page 65. As to Howard, the Policy was void on June 2, 2010. W. Va. Code § 33-6-3(a), (b); Syl. Pt. 1, *Filiatreau*, 358 S.E.2d 829.

Having foreclosed on the Home on May 27, 2010, Bank was not a "mortgagee" on May 31 or June 2, 2010, when the Water Damage Claim arose. *Complaint* ¶¶ 22; 55 Am.Jur.2d *Mortgages* § 573; *Jones*, 460 S.E.2d at 628 n. 1; *Santiago*, 928 N.E.2d at 362; Syl. Pt. 2, *West Virginia Fire & Cas. Co. v. Stanley*, 216 W. Va. 40, 602 S.E.2d 483 (2004) (citation omitted) (Court applies clear policy terms). Bank then had only an ownership interest in the Home, but even if valid, the Policy could have insured Bank only as Mortgagee, never as the Home's owner. 55 Am.Jur.2d *Mortgages* § 573; *Jones*, 460 S.E.2d at 628 n. 1; Syl. Pt. 4, *id.*; *Santiago*, 928 N.E.2d at 362; Syl. Pt. 2, *Stanley*, 602 S.E.2d 483; *Complaint* Exh. B, Policy Declarations. As to Bank as Mortgagee, the Policy was both void on May 31 and June 2, 2010, and could not by its terms have provided coverage for the Bank's interest in the Home. W. Va. Code § 33-6-3(a), (b); Syl. Pt. 1, *Filiatreau*, 358 S.E.2d 829; **Exhibit B**, Policy excerpt, Mortgage Clause; Syl. Pt. 2, *Stanley*, 602 S.E.2d 483.

The Policy was void on the May 31 or June 2, 2010, date of loss. Even if, as Bank alleges, the Policy was valid at some earlier time, the Policy could not cover Bank with respect to the Water Damage Claim. Encompass Indemnity Company is entitled to dismissal of Bank's breach of contract claim and its derivative common law bad faith, UTPA, declaratory judgment, and estoppel/waiver claims, *Complaint* Counts I-IV, and to dismissal of this action, with prejudice. W. Va. R. Civ. P. 12(b)(6); *Hottle*, 47 F.3d at 109; *Twombly*, 550 U.S. at 555; *Ashcroft*, 129 S.Ct. at 1961; *Spear Pharmaceuticals*, 610 F.Supp.2d at 283; *Lormand*, 565 F.3d at 232; *Hall*, 385 F.3d at 424 n.3; *Papasan*, 478 U.S. at 268 n. 1; *Am. Chiropractic*, 367 F.3d at 234; *Blankenship*, 410 F.Supp.2d at 487; *Yoak*, 672 S.E.2d at 195; *Harrison*, 478 S.E.2d at 109; *Forshey*, 671 S.E.2d at 750.

CONCLUSION

For the above reasons, Defendant Encompass Indemnity Company asks the Court to dismiss the *Complaint* of Plaintiff, Bank of Charles Town, for failure to state a claim on which relief could be granted, and to dismiss this action, with prejudice. W. Va. R. Civ. P. 12(b)(6).

ENCOMPASS INDEMNITY COMPANY,

By counsel,

/s/ *Ellen R. Archibald*

Brent K. Kesner (WVSB #2022)
Tanya M. Kesner (WVSB #5162)
Ellen R. Archibald (WVSB #5183)
Kesner, Kesner & Bramble, PLLC
112 Capitol Street
P. O. Box 2587
Charleston, WV 25329
Phone: (304) 345-5200
Fax: (304) 345-5265
Counsel for Defendants

E. Kay Fuller (WVSB #5594)
Martin & Seibert, LC
1453 Winchester Ave.
P. O. Box 1286
Martinsburg, WV 25402-1286
Counsel for Defendants on Plaintiff's Extracontractual Claims

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CERTIFICATE OF SERVICE

I, Ellen R. Archibald, counsel for Defendants, certify that the foregoing **MEMORANDUM IN SUPPORT OF MOTION TO DISMISS** was served this 7th day of October, 2010, with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to the following as follows:

Stephen G. Skinner, Esq.
Nichols & Skinner, LC
P.O. Box 487
Charles Town, WV 25414
Counsel for Plaintiff

E. Kay Fuller
Martin & Seibert, LC
1453 Winchester Ave.
P. O. Box 1286
Martinsburg, WV 25402-1286
Counsel for Defendants on Plaintiff's Extra Contractual Claims

/s/ *Ellen R. Archibald*

Brent K. Kesner (WVSB #2022)
Tanya M. Kesner (WVSB #5162)
Ellen R. Archibald (WVSB #5183)
Kesner Kesner & Bramble, PLLC
P.O. Box 2587
Charleston, WV 25329
Phone: (304) 345-5200
Fax: (304) 345-5265